The macroprudential policy strategy for Austria

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Preamble

1. In line with recommendation ESRB/2013/1 by the European Systemic Risk Board, the ultimate objective of Austria's macroprudential policy consists in making a material contribution to safeguarding the stability of the Austrian financial system as a whole. To this end, Austria's macroprudential supervisors are committed to pursuing and fulfilling predefined intermediate objectives (see the section "Objectives of macroprudential supervision in Austria" starting from margin no. 4).

2. The macroprudential policy strategy lays down the cornerstones for implementing macroprudential policy in Austria with a view to fostering the decision-making process as well as communication and accountability to the general public. Under Austrian law, macroprudential supervision is a shared responsibility of the Financial Market Stability Board (FMSB), the Financial Market Authority (FMA) and the Oesterreichische Nationalbank (OeNB). Hence, there is a need for an interinstitutional macroprudential policy strategy. In the following text, the terms "macroprudential supervision in Austria" and "Austrian macroprudential supervisors" refer collectively to the FMSB, FMA and OeNB and their cooperation. Whenever the focus is on the specific role of one of these institutions, this institution will be explicitly named.

3. The wording of the macroprudential policy strategy for Austria has been aligned with the legal provisions laid down in the Austrian Banking Act (Bankwesengesetz – BWG), the Alternative Investment Fund Managers Act (Alternatives Investmentfonds Manager-Gesetz – AIFMG), the Financial Market Authority Act (Finanzmarktaufsichtsbehördengesetz – FMABG) and the Nationalbank Act (Nationalbankgesetz – NBG) (including explanatory materials to the government bill related to Federal Law Gazette I No. 184/2013), the Bank Recovery and Resolution Act (Bankenabwicklungs- und Sanierungsgesetz – BaSAG), the European framework (macroprudential supervision under the Single Supervisory Mechanism (SSM) and tasks and competences of the European Systemic Risk Board (ESRB) and the ESRB's recommendations.

Objectives of macroprudential supervision in Austria

4. Macroprudential supervision in Austria aims primarily at safeguarding the stability of the Austrian financial system, thereby contributing to the overall objective of sustainable economic growth in Austria.

5. Financial stability is improved by strengthening the resilience of the financial system and by reducing systemic risks in the financial system, which, in turn, makes crisis prevention more effective. This is meant to ensure that the financial system contributes to sustainable medium- and long-term economic growth.[1] Financial stability means that the financial system can absorb the consequences of significant

[1] See also the explanatory materials to the government bill related to Federal Law Gazette I No. 184/2013, p. 11.

exogenous or endogenous shocks – and in particular without any assistance from taxpayers. In such an environment, orderly market exits of financial institutions do not cause financial instability.

6. Macroprudential measures are preventive in nature, i.e. they increase the risk-bearing capacity of the financial system in times when systemic risks are prevalent or building up. Once these risks are decreasing or have been eliminated, macroprudential supervisors will loosen or scale back previously adopted measures. This may, in particular, mean that macroprudential requirements, which are also meant to serve as absorption buffers, are being loosened or scaled back in the event of a crisis. This applies especially to the countercyclical capital buffer (see margin no. 30), whose activation and level depend on the credit cycle.

7. In line with the above-mentioned overarching goal, Austria's macroprudential supervisors pursue six intermediate objectives to implement the ESRB's recommendation[2]:
   i. *Mitigating and preventing excessive credit growth and leverage:* Excessive credit growth and excessive leverage rank among the key drivers of asset price bubbles and resulting financial crises.
   ii. *Mitigating and preventing excessive maturity mismatches between financial companies' assets and liabilities as well as liquidity shortages in the markets/market illiquidity:* Excessive use of short-term and volatile funding sources may entail the need for fire sales, which, in turn, could cause illiquidity spirals and contagion effects.
   iii. *Limiting the concentration of direct and indirect exposures:* Given a high degree of interconnectedness, shocks in individual financial institutions or segments of the financial system may quickly spread within the financial system and to other parts of the economy via direct links or correlated exposures.
   iv. *Limiting the systemic impact of misaligned incentives, in particular with a view to reducing moral hazard:* Misaligned incentives result from explicit and implicit government guarantees, from the fact that the probability of implicit state guarantees rises with the size/significance of an institution and from other distortions.
   v. *Strengthening the resilience of financial infrastructures[3]:* Distorted incentives stemming from, for instance, legislation, deposit guarantees, the role of rating agencies, market practices or payment and securities settlement systems may give rise to systemic risks.
   vi. *Minimizing information deficits: This is meant to ensure the efficient identification of systemic risks and thus make macroprudential supervision more effective.* Minimizing information deficits involves both the supervisors' closing of data gaps and raising awareness among companies subject to supervision and consumers of financial services (market transparency).

[2] Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1).
[3] Financial infrastructures comprise the legal and regulatory environment (including resolution regimes and deposit guarantee schemes), monitoring, accounting and auditing standards, payment and settlement systems (including central counterparties), corporate governance rules, information infrastructures (disclosure practices, transparency rules, rating agencies, analysts), etc. See also Bossone, B., S. Mahajan and F. Zahir. 2003. Financial Infrastructure, Group Interests, and Capital Accumulation. Theory, Evidence, and Policy. IMF Working Paper WP/03/24. Washington, D.C.

Principles of macroprudential supervision in Austria

8. Introducing macroprudential supervision was a key lesson from the global financial and economic crisis of 2008 and 2009: in order to safeguard financial stability it does not suffice to ensure that individual institutions remain solvent and to maintain fair and transparent market conditions. Monetary policy with its primary objective of maintaining price stability alone is not enough to address systemic risks in the financial system.[4]

9. Macroprudential supervisors aim at making a significant contribution to safeguarding the stability of the Austrian financial market, but not at fine-tuning business cycles and price growth or eliminating financial risks. Macroprudential supervisors are committed to upholding the principles of a social market economy.

10. Macroprudential supervisors act in line with a public mandate and in the public interest. In this context, it is vital to improve market participants' and the general public's knowledge about issues concerning financial stability and systemic risks. Transparency plays a crucial role in making macroprudential decisions more consistent and predictable. Consultations with market participants as potential addressees of macroprudential decisions help inform market participants about the background of such decisions, and macroprudential supervisors benefit from the exchange with market participants in that it enables them to make more informed decisions. For these reasons, macroprudential supervisors are committed to ensuring the highest possible degree of transparency. This is an important element in meeting the accountability requirements vis-à-vis the general public. Supervisors shall compromise on the principle of transparency only if disclosure would entail additional risks to financial stability or sharing particular information would be against the law.

11. Given its long-term perspective, macroprudential supervision in Austria helps foster sustainable economic growth. Decision makers are aware of the fact that, over the short term, effective macroprudential policy will go hand in hand with dampening effects on major economic aggregates and indicators – such as credit growth, investment, consumption and GDP – but that it will contribute to attaining higher and less volatile economic growth over the long term[5]. Before taking a measure, macroprudential supervisors conduct a cost-benefit analysis. Minimizing procyclical side effects on the economy, which might, in turn, have adverse repercussions for financial stability, is key whenever supervisors introduce, tighten or loosen macroprudential policy instruments.

12. As the introduction and tightening of measures can be expected to push up costs for borrowers, financial market players or the economy in the short run, the objectives of macroprudential supervisors may often conflict with the short- and medium-term objectives of the financial industry and other stakeholders.

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[4] See also the explanatory materials to the government bill related to Federal Law Gazette I No. 184/2013, p. 11.

[5] See also the explanatory materials to the government bill related to Federal Law Gazette I No. 184/2013, p. 8f.

13. Macroprudential supervisors in Austria stress their independence from politics and the financial industry. In fulfilling their functions, FMSB members are, according to Article 13 paragraph 4 Financial Market Authority Act, not bound by instructions received from their sending institutions.

14. Macroprudential supervisors will always have to make decisions under a certain degree of uncertainty. Even highly sophisticated models and the best data available will not suffice to completely eliminate the uncertainty surrounding forward-looking measures.

15. Before taking a particular measure, macroprudential supervisors generally weigh several options and then choose the one promising to be the most effective while entailing minimal side effects and evasive reactions.

16. In their analyses and decision making, macroprudential supervisors moreover consider complementarities and conflicts with microprudential and monetary policy objectives and measures with the aim of using these complementarities in an optimal manner.

17. Playing a central role in financial intermediation in Austria, the banking sector primarily bears and causes systemic risks. Hence, the focus of macroprudential supervision in Austria is on the systemic risks of the banking sector. Yet, systemic risks in the financial sector may also be caused or amplified and spread by other players, such as nonbanks (e.g. insurance companies, pension funds, severance funds, asset managers and investment funds). Likewise, structural changes and evasive reactions may lead to an increase of systemic risks at, or a shift to, nonbanks, which is why macroprudential supervision in Austria is tasked with covering systemic risks across all segments of the financial sector.

18. Cross-border aspects are becoming ever more important for macroprudential supervision as well, not least because Austrian financial institutions – above all banks and insurance companies – are heavily invested in European emerging economies and given the macroprudential roles of the ECB and the ESRB. Austrian macroprudential supervisors hence not only give due consideration to the cross-border consequences of their decisions and measures, but also firmly support cooperation within the Single Supervisory Mechanism (SSM) and actively participate in the ESRB. In this context, macroprudential supervisors in Austria therefore back any efforts toward strengthening the principle of reciprocity[6] and advancing it at the European level based on cost-benefit considerations.

Tasks and operating framework of macroprudential supervision in Austria

19. The mandate of macroprudential supervision in Austria encompasses all the (macroprudential) tasks of the individual institutions involved, with the FMSB being the central macroprudential decision-making body. The FMSB consists of two representatives each of the Federal Ministry of Finance

[6] Under the reciprocity principle, reciprocation occurs when the relevant authority in one Member State applies the same, or equivalent, macroprudential measure as that activated in another Member State in order to address a risk related to the specific exposure in the other Member State.

(chair) and the Fiscal Advisory Council as well as one representative each of the OeNB and the FMA. Thus, the FMSB is the link between the institutions in charge of financial market regulation and financial market supervision. In addition, the Fiscal Advisory Council ensures that consideration is also given to overall business conditions and the objective of sustainable public finances[7].

20. The tasks of the Financial Market Stability Board have been defined in Article 13 paragraph 3 of the Federal Act on the Institution and Organization of the Financial Market Authority:
    i. discussing facts relevant to financial market stability;
    ii. encouraging cooperation and the exchange of opinions among the institutions represented on the Board in normal times and in times of crisis;
    iii. issuing expert opinions, recommendations and requests in connection with the capital risk of institutions and a resulting systemic threat;
    iv. issuing warnings about risks that may have an adverse impact on financial stability;
    v. issuing recommendations to the FMA with a view to averting risks to financial stability;
    vi. advising the FMA on how to deal with warnings and recommendations of the European Systemic Risk Board;
    vii. presenting a report to parliament and the minister of finance on an annual basis.

    Furthermore, in line with Article 29 paragraph 5 BaSAG, the Austrian resolution authority must hear the FMSB before deciding on a measure to reduce or eliminate obstacles to the resolvability of an institution.

21. The FMA is designated by law as the competent authority for applying macroprudential instruments. Hence, the FMA is the competent authority for implementing measures to contain systemic risk according to the provisions in the Austrian Banking Act (BWG), the Capital Requirements Regulation (CRR) and the Alternative Investment Fund Managers Act (AIFMG). Moreover, the FMA must, in its actions, give due consideration to the consequences for the stability of the financial system and to the macroeconomic interest in efficient capital markets in line with material legislation, in particular with Article 267 Insurance Companies Supervision Act 2016, Article 33 Pension Fund Act, Article 90 Securities Supervision Act, Article 82 Stock Exchange Act and Article 143 Investment Fund Act.

22. The OeNB's macroprudential tasks are laid down in Article 44c Nationalbank Act:
    i. analyzing the financial market facts relevant for maintaining financial stability and reducing systemic risk and identifying threats to financial stability;
    ii. informing the Financial Market Stability Board about both general and specific observations and findings and – upon request – providing facts deemed necessary for corroboration; providing material and drawing up expert opinions;
    iii. preparing recommendations to be submitted to the FMA and risk warnings for the FMSB;
    iv. analyzing the implementing measures of the FMA and informing the FMSB about how the OeNB assesses these implementing measures;
    v. drafting the annual report of the FMSB about its activities and financial stability developments.

[7] See also the explanatory materials to the government bill related to Federal Law Gazette I No. 184/2013, p. 72f.

The OeNB also performs the following additional macroprudential tasks: drawing up expert opinions on the activation of macroprudential instruments in line with Articles 22a to 23d Banking Act and on the evaluation of systemic risks resulting from the use of leverage funding in line with the Alternative Investment Fund Managers Act (AIFMG). Also, the OeNB is involved in examining the conditions for resolution in line with the Bank Recovery and Resolution Act (BaSAG)[8].

Indicators and models

23. Macroprudential supervisors in Austria are committed to following a theory- and evidence-based macroprudential policy to ensure a transparent decision-making process.

24. To ensure macroprudential supervisors' ability to take action as needed, the strategy cannot be tied to a detailed predefined set of data, indicators and models. Rather, it is a key part of supervisors' day-to-day business to continuously refine relevant indicators and models by considering new findings and requirements.

25. The intermediate macroprudential objectives frame the parameters within which indicators and models are analyzed and developed. Analyses should focus on those intermediate objectives for which the degree of compliance is considered to be insufficient. This also applies to those intermediate objectives for which action has already been taken with a view to allowing a regular and timely evaluation of the effectiveness of the implemented measures.

26. Using data at the level of individual financial institutions or assets is a prerequisite for developing meaningful indicators and models for macroprudential supervision. Whenever macroprudential supervisors require data at the level of individual financial institutions, they draw primarily on data that are already available to their microprudential counterparts (especially in the area of prudential reporting) to avoid duplicating work at financial institutions and duplicating analyses. The use of such information is subject to the same confidentiality regime applicable to microprudential supervision.

27. Quantifying effects on credit availability (or the availability of other financial services essential for an economy) and on economic growth is also an important task of macroprudential supervision. In particular, this refers to the quantification of the immediate costs in case of constrained credit availability in the short term and of the indirect benefits of a reduced probability of crises and lower crisis costs. Whenever such quantifications are not feasible, supervisors will carry out theory-based qualitative assessments instead.

[8] "Public interest" in Article 49 paragraph 1 no. 3 BaSAG in connection with the resolution objective set out in Article 48 paragraph 2 no. 2 BaSAG "Avoiding a significant negative impact on financial stability."

Policy options and macroprudential instruments

28. The following macroprudential instruments for the banking sector serve to address systemic risks: measures to limit systemic risk (Article 22a Banking Act and Article 458 CRR, respectively), countercyclical buffer (Article 23a Banking Act), buffer for systemically important financial institutions (Articles 23b and 23c Banking Act), systemic risk buffer (Article 23d Banking Act), measures for containing systemic risk arising from immovable property financing (Article 22b Banking Act), risk weights and minimum LGDs for mortgages on immovable property (Articles 124 and 164 CRR). Moreover, the Alternative Investment Fund Managers Act (AIFMG) contains provisions on limiting the volume of leverage funding of alternative investment funds (Article 23 AIFMG).

29. The measures to contain systemic risk (Article 22a Banking Act and Article 458 CRR, respectively) address various intermediate objectives set for macroprudential supervision. If the FMA identifies changes in the intensity of systemic risks in the financial system, it may, based on a recommendation by the FMSB, amend the instruments described below for a period of two years. In this context, the instruments are subject to a "European safeguard procedure" laid down in Article 458 CRR.
    i. Changing the level of the own funds requirements set forth in Article 92 CRR may serve to contain the systemic effects of misaligned incentives by reducing moral hazard.
    ii. Changing the own funds requirements for large exposures set forth in Articles 392, 395–403 CRR may serve to limit direct and indirect exposure concentrations.
    iii. Changing the disclosure requirements set forth in Articles 431–455 CRR may serve to minimize information deficits.
    iv. Changing the liquidity coverage requirements set forth in part 6 CRR may serve to mitigate and prevent excessive maturity mismatches between financial companies' assets and liabilities as well as liquidity shortages in the markets.
    v. Changing the risk weights to combat real estate bubbles may serve to mitigate and prevent excessive credit growth and leverage.
    vi. Changing the risk weights for risk positions within the financial industry may serve to both mitigate and prevent excessive credit growth and leverage and limit direct and indirect exposure concentrations.

30. The countercyclical capital buffer (Article 23a Banking Act) is to address cyclical systemic risks, especially those arising from the credit cycle. As such, this buffer serves to meet the intermediate objective of mitigating and preventing excessive credit growth and leverage.

31. The two buffers for systemically important financial institutions – the global systemically important institution (G-SII) buffer and the other systemically important institution (O-SII) buffer – are to be used when a systemic risk arises from a given bank. In other words, these buffers are to be used when that bank's failure threatens to distress other banks and financial institutions and to cause related costs to the real economy and the taxpayer. Such a bank is more likely to be bailed out by taxpayers to prevent contagion. Put differently, the G-SII and the O-SII buffers serve to limit the systemic impact of misaligned incentives.

32. The systemic risk buffer (Article 23d Banking Act) addresses long-term noncyclical systemic risks. It may be applied broadly and serves to address all structural systemic risks that do not arise from individual banks, i.e. systemic risks not covered by the buffer for systemically relevant institutions. Such risks may, for instance, arise from the size of the banking sector, the setup of the deposit insurance scheme, the similarity of business models, correlated risk positions of many individual or especially significant institutions, reputational risks threatening large parts of the financial system and shocks resulting from changes in the legal or regulatory environment. This way, the systemic risk buffer may serve to limit both direct and indirect exposure concentrations and the systemic impact of misaligned incentives.

33. The instruments for containing systemic risk that arises from immovable property financing (Article 22b Banking Act) have been introduced to address financial stability risks emanating from the debt financing of real estate. They consist of limits on loan-to-value ratios, debt-to-income ratios and debt service-to-income ratios and maturities of new immovable property loans. It will also be possible to establish criteria regarding the amortization of new immovable property loans. Applying these instruments serves the intermediate objective of mitigating and preventing excessive credit growth and leverage.

34. For financial stability considerations, the risk weights applicable to exposures secured by mortgages on immovable property may be increased in the standardized approach (Article 124 CRR) or the minimum values of the risk-weighted average loss given default (LGD) of exposures secured by mortgages on immovable property may be increased in the IRB approach (Article 164 CRR). These instruments are also considered to be macroprudential instruments even though the FMSB has not been explicitly assigned a role in the respective legal provisions. Increasing the risk weights or the minimum LGDs may serve to both mitigate and prevent excessive credit growth and leverage and limit direct and indirect exposure concentrations.

35. A limit on the amount of leverage funding that an alternative investment fund manager may use (Article 23 AIFMG) must be set when such a limit is, inter alia, deemed to be necessary for safeguarding the stability of the financial system and when the use of leverage funding contributes to the emergence of systemic risks in the financial system or of the risk of market disruptions in individual or several market segments. Before taking this measure, the European Securities and Markets Authority (ESMA), the ESRB and, if warranted, the competent authorities with respect to the alternative investment fund in question must be notified; ESMA must then issue a recommendation for this measure. As illustrated by the recent financial crisis, alternative investment fund managers' activities may likewise help spread or amplify risks throughout the financial system. Hence, limiting the amount of leverage funding may serve to mitigate and prevent excessive leverage.

36. Macroprudential supervisors perform additional tasks that relate to the assessment of compliance with the resolution objective of preventing material negative effects on the stability of the financial market when a given institution is wound up (Article 48 paragraph 2 no. 2 BaSAG). No macroprudential measures have been defined for this case, however. Nevertheless, ensuring an orderly market exit of credit institutions without causing material negative repercussions for other parts of the financial

system or the economy as a whole is essential in the pursuit of the intermediate objective of containing the systemic effects of misaligned incentives.

37. Another effective instrument used by macroprudential supervisors is publishing analyses and issuing risk warnings based on the following rationale: The greater market participants' awareness is, the more informed their decisions will be, which is expected to contribute to financial stability.

38. Austrian macroprudential supervisors are committed to identifying important instruments that are not yet in place but necessary to meet the agreed objectives and to inform the Federal Minister of Finance of such instruments.

Evaluation of the intermediate objectives and the policy strategy

39. The FMSB evaluates on a regular basis – at least once a year – whether the macroprudential intermediate objectives have been reached and whether the measures taken have been effective. If necessary, it recommends using new or adapting existing measures.

40. To ensure that the macroprudential policy strategy is effective and efficient, it is evaluated (and adapted if necessary) at least every two years for its adequacy and feasibility by the institutions named in margin no. 19.